**AN ESSAY ON MANAGER COMPENSATION IN LIFE INSURANCE INDUSTRY**
**(An Empirical Investigation on the Relationship between Bonus Compensation and Reinsurance Activity)**

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University of Nebraska, 1998

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The Life insurance industry has been heavily regulated by the authorities because it plays a very important role in society and because insurance contracts are not easy to understand for general customers. Heavy regulation results in less discretion for managers to decide. However most regulations emphasize the solvency test and pay less attention to the manager compensation issue. Also, the close regulation and the alleged less managerial discretion do not solve the agency problem between managers and owners.

This study is an evaluation of managerial compensation as it relates to reinsurance activity. The approach taken is to empirically test the following proposition: is managerial compensation a determinant of the reinsurance activity; if so, it should be significantly related to reinsurance activity.

Reinsurance is a contract to shift part or all of the insurance originally written by one insurer, the ceding company, to another insurer, the reinsurer. The reinsurance activity, most importantly determining the amount of insurance retained by the ceding company for its own account, is subject to considerable management discretion. The setting of an appropriate reinsurance amount is a non-trivial decision for an insurer. It ultimately affects both the risk exposure and the profitability of the ceding company. Also, it impacts annual income of the insurer significantly. As a result, reinsurance activity represents a potentially significant area for insurance company managers to attempt to manage earnings. Theoretically, reinsurance activity

should represent underlying economic reality.  Many variables influence reinsurance activity and many considerations can be involved in determining an accurate reinsurance activity.

The first finding provides some preliminary evidence that managers manage the income but they do not manage the income for compensation purposes but rather for income smoothing. The results from extended research give only limited support to the theory that managers may in restricted case manage earnings to affect their bonus income.

The mixed results may be attributable to the following reasons.  First, some companies do not change reinsurance activity yearly, especially when the reinsurance contract is an automatic basis.  Second, due to recapture provisions, the impact on annual income by the change of legal reserve caused by different reinsurance for new policies is limited.